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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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| In the Matter of | ) | |
| | ) | |
| Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 | ) | MM Docket 92-266 |
| | ) | |
| Rate Regulation | ) | |

REQUEST FOR LEAVE TO FILE IN EXCESS OF PAGE LIMITATION

King County, Washington; Austin, Texas; Dayton, Ohio; Gillette, Wyoming; Montgomery County, Maryland; St. Louis, Missouri; and Wadsworth, Ohio ("Coalition") hereby request leave to exceed the 25-page limitation in its opposition to petitions for reconsideration in the above proceeding. The Coalition believes the request is justified in light of the following:

(1) The Coalition is filing a single opposition in response to nine petitions for reconsideration. Specifically, the opposition responds to petitions filed by the Coalition of Small Systems ("Small Systems"), Community Antenna Television Association ("CATA"), Continental Cablevision, Inc. ("Continental"), Corning Incorporated and Scientific-Atlanta, Inc. ("Corning"), Harron Communications, Corp. ("Harron"), National Cable Television Association ("NCTA"), Tele-Communications, Inc. ("TCI"), Time Warner Entertainment Company, L.P. ("Time Warner"), and Viacom International, Inc. ("Viacom"). If the Coalition filed individual oppositions, it would be able to submit a total of 225 pages.

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(2) The Coalition believes that a single opposition is the best way to respond to the above petitions filed by or on behalf of the cable industry. Many of the claims raised are repetitive, and can be responded to collectively. Many of the claims are inconsistent, and these inconsistencies can best be identified

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OPPOSITION TO PETITIONS
FOR RECONSIDERATION

King County, Washington; Austin, Texas; Dayton, Ohio;
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## OPPOSITION TO PETITIONS FOR RECONSIDERATION

King County, Washington; Austin, Texas; Dayton, Ohio; Gillette, Wyoming; Montgomery County, Maryland; St. Louis, Missouri; and Wadsworth, Ohio ("Coalition") hereby oppose portions of the petitions for reconsideration filed by Coalition of Small Systems ("Small Systems"), Community Antenna Television Association ("CATA"), Continental Cablevision, Inc. ("Continental"), Corning Incorporated and Scientific-Atlanta, Inc. ("Corning"), Harron Communications, Corp. ("Harron"), National Cable Television Association ("NCTA"), Tele-Communications, Inc. ("TCI"), Time Warner Entertainment Company, L.P. ("Time Warner"), and Viacom International, Inc. ("Viacom").

## I. THE FCC SHOULD ELIMINATE ALL MONOPOLY PROFITS

### A. The Statute Requires Rate Reductions

Petitions filed by and on behalf of the cable industry complain that the benchmarks will reduce revenues, and in one form or another, urge the FCC to allow operators to continue to charge excessive amounts to subscribers, in order to avoid alleged harm to the industry. For reasons described below, industry claims that revenues will be reduced over any significant period are unsupported and incorrect. More significantly, however, the statute does not permit the FCC to devise a scheme designed to minimize impact on operators' monopoly profits.

Congress recognized that cable operators in the vast majority of communities are monopoly providers. See e.g., S.Rep. No. 92, 102d Cong., 2d Sess. at 8-9 (1992), reprinted in 1992 U.S.C.C.A.N. at 1140-1141 ("Senate Report"). Congress also recognized that in the deregulated environment existing prior to adoption of the Cable Television Consumer Protection and Competition Act of 1992 ("Act"), most subscribers were "at the mercy of a cable operators' market power." Senate Report at 8, 1992 U.S.C.C.A.N. 1133, 1140. Unregulated monopoly rates have been estimated to be 30 to 50 percent too high,[1] amounting to overcharges of approximately $6 billion a year.[2] Congress enacted legislation to protect subscribers from existing market power abuses by monopoly operators. Section 2(a)(1) and (2) of

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[1]Robert Rubinovitz, Market Power & Price Increases for Basic Cable Service Since Deregulation, (U.S. Department of Justice, Antitrust Division, Economic Analysis Group, August 6, 1991). Accord Comments of Austin, Texas, et al., Jay Smith study, Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992, MM Docket 92-266 (January 27, 1993).

[2]Cable Television Regulation Hearings Before the Subcommittee on Telecommunications and Finance of the Committee on Energy and Commerce on H.R. 1303 and H.R. 2546, 102d Cong., 1st Sess. 699 (1991) (statement of Gene Kimmelman, Legislative Director of the Consumer Federation of America).

the Act. Even industry studies recognize that the Act was intended to eliminate monopoly rents from cable services regulated by the Act, and to ensure that "all cable subscribers enjoy the benefits of presumed competitive rates for cable services." Viacom petition, RAND study at 2.[3]

Congress imposed rate regulation precisely to eliminate the monopoly rents that are presently being collected by the cable industry. The relevant issue is not whether the regulations decrease operator revenues, but whether the FCC has gone for enough to decrease regulated rates to comply with the mandate from Congress.[4]

### B. Eliminating the Industry's Monopoly Profit is Good Public Policy

The industry claims that it will be competitively disadvantaged by the new rate regulations. It seems to suggest that it depends on its monopoly power to maintain its position in the face of competition from new market entrants and new technologies. CATA, for example, claims that systems with 1,000

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[3]Despite plain statements by Congress that only a tiny portion of communites face effective competition, operators urge the FCC to find competition where none exists. For instance Time Warner claims that the 15 percent penetration calculation in 47 U.S.C. § 543(1)(1)(ii) is independent of, and should not be limited to, systems offering service to 50 percent of the community. Such an interpretation would violate the plain language of the Act, as well as make a mockery of the

or fewer subscribers won't be able to refinance, and will be forced out of business by new technologies, and that, ultimately, subscribers will be the losers. CATA petition at 4-5. But if new technologies can provide comparable service for less money, it is not apparent that subscribers will be harmed in any way. To the contrary, subscribers will benefit from new market entrants that are able to provide service at lower cost (and that can obtain financing in the face of competition from the cable industry). The FCC need not and should not set up a protectionist regulatory system for the cable industry that enables it to thrive where it would not, in a competitive environment, survive.

Indeed in other circumstances the industry has opposed the very rationale it uses here as a justification for higher rates. For example, NCTA objected to the assignment of a video dialtone applicant of "only the direct incremental costs of the video dialtone portion of the video dialtone to the service, requiring telephone ratepayers to bear the direct costs of telephone service <u>and</u> all of the common costs of both services." Reply to Opposition to Petitions to Deny of the National Cable Television Association, <u>The Chesapeake and Potomac Telephone Co. of Virginia</u>, No. W-P-C 6834 at 8-9 (filed December 28, 1992) (emphasis in original). <u>See also</u>, Daniel L. Brenner, Law and Regulation of Common Carriers in the Communications Industry, 154-157 (1992). Brenner notes that cross-subsidization can impede competition if a monopolist is permitted to exploit its market advantages in one area to gain advantages in another area be seen in comparisons of monopoly and competitive cable systems submitted by the industry itself. See e.g., Viacom petition, RAND study at 9 (showing that overbuild systems on average are newer, have greater channel capacity, offer more satellite services on regulated tiers, offer more pay channels, have lower churn, and charge lower per-channel rates).

The industry asserts that the new benchmarks will reduce cash flow and make financing more difficult. But they never demonstrate that their existing financing is reasonable, that their past expenditures have been prudent, or that their financing and expenditures would exist in a competitive environment. In fact, sustaining financing arrangements that would not occur if competitive rates are charged harms development of competition. It is unfair to make new market entrants, which have not had the advantage of a monopoly position and which have not had the benefit of the prodigious cash flow level enjoyed by the cable industry, compete for financing on those terms.

### C. The Industry Has Not Demonstrated that the FCC's Rate Regulations Will Unfairly Harm Them Financially

The petitions for reconsideration filed by the above-named industry representatives do not show that the benchmarks are unfairly low, or that the regulatory method established by the FCC will be non-compensatory. The petitions do not even show that overall revenues for both regulated and non-regulated services will decline,[6] much less decrease over the life of the franchise. None of the operators has provided evidence that it cannot cover its costs and obtain a reasonable profit under the FCC's regulatory system. At best, the operators cite some evidence that they will lose money over a specified, short period of time. For example, an affidavit filed on behalf of the Coalition of Small System Operators shows that there will be a greater loss of revenues under FCC benchmarks in the next 12 months. See Small Systems petition, Exh. 3. The operators do not assert, however, that they will not recover their investment (and make a profit) over the life of the franchise.

Moreover, claims that operators will face net losses under the new rate regulations prove little. Cable operators generally show accounting "losses."[7] Yet they still report financial solidity to investors and lenders, by pointing to healthy cash flow,[8] and sell what they would have the FCC believe are albatross ventures for hundreds of millions of dollars profit.

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[6]This is a crucial omission. Regulation will likely shift revenues from regulated to unregulated services, as the industry recognizes. See Viacom petition, RAND study at 11. Such shifting to reflect costs and eliminate subsidization by monopoly services is a desirable result, as noted above.

[7]John Higgins, MSOs Facing $2B Hit from New FASB Rule, Multichannel News, April 5, 1993, at 33, attached as Exhibit A; K.C. Neel, Profits to Become benchmark at TCI, Cable World, March 22, 1993 at 29, attached as Exhibit B. See also Small Systems petition, Exhs. 6 and 7 (systems claiming to operate on a net loss prior to adoption of the FCC's new regulations).

[8]Exhibit B, (John Malone, president of TCI, admitted the company chose not to report profits merely as a way to avoid paying taxes).

For example, Hauser Communications, Inc. is selling its cable system in Montgomery County, Maryland for a profit of nearly $300 million (post-FCC regulation), although that system has thus far shown a net loss on its books.[9] See Exhibit C. U.S. West has agreed to pay $2.5 billion for a quarter of Time Warner Entertainment Company, despite the new regulations. John Higgins and Peter Lambert, Giving High Technology a Reality Check, Multichannel News, June 14, 1993 at 1, 69 attached as Exhibit D. Industry investment in the new "electronic highway" also appears to be unfettered by rate regulations. See Exhibit B (TCI plans to spend about $300 million a year over the next three years to deploy digital compression in all its systems; press release from Tele-Communications, Inc. (Englewood, Colorado), April 12, 1993, attached as Exhibit E, (announcing TCI's plans to "accelerate" fiber optic upgrades and replacements over the next four years at an estimated cost of more than $1.9 billion).

While there is substantial conjecture that the new regulations will force operators to breach existing loan agreements, there is no real proof that this is so. Corning petition. See also Letter from Bank of America, et al. to the FCC, MM Docket 92-266, dated June 21, 1993 ("Bank letter"). In fact, the lending institutions concede that they do not yet know

[9] Hauser Communications, Inc. acquired the system for about $40 million in 1986, and has invested an additional $200 million. Southwestern Bell is purchasing the Montgomery County system for $534 million (that amount is incorrectly identified in the article by Paul Farhi and Cindy Skrzycki, Southwestern Bell to Buy Arlington, Montgomery Cable, The Washington Post, February 10, 1993, at C1.

the effect the regulations will have on existing and future financing arrangements. Bank letter at 2. Some operators have stated plainly that the new regulations will not substantially harm business operations, or reverse the cable industry's competitive advantages. Paul Farhi, FCC Moves Up Cable TV Rate Rollback, The Washington Post, July 21, 1993, at F2, attached as Exhibit F; John Higgins, Malone: Rules Harsh But 'Immaterial', Multichannel News, April 5, 1993, at 40, attached as Exhibit G. See also Tele-Communications, Inc., Prospectus, filed with the Securities and Exchange Commission, May 25, 1993 at 3 (describing the general impact of the FCC's rate regulations and asserting that TCI expects to continue to be able to satisfy its debt service and other obligations). Other financial analysts agree. John Higgins, Study Sees Slight Damage from All Re-Regulation, Multichannel News, July 19, 1993, at 82, attached as Exhibit H (damage from rate regulation is predicted to be insubstantial).

The industry goes to great lengths before the FCC to suggest that even the limited rate reductions will prevent operators from satisfying interest coverage and debt: equity requirements. But its predictions as to cash flow reductions resulting from the regulations adopted by the FCC are exaggerated. The industry assumes, for example, that rates on average will decrease by 10 percent under the FCC's benchmarks. The Coalition has pointed out that this assumption is not correct, and this position is supported by the record. For example, one operator estimates that "the average rollback for the whole industry will be just under 6.5%." Viacom petition, RAND study at 20. Even this estimate is probably high, because it does not appear to account for operators that may maintain their current rates based on a cost of service showing.[10]

Another important factor ignored by the industry studies is that a large portion of revenues will not be affected at all by the FCC's new rules. Pay services, advertising and other revenues will remain the same -- or may increase if the operator

FCC are likely to have very minimal effect even on the monopoly financing arrangements that presently exist.[12]

[redacted]

Time Warner and NCTA submitted analyses (by NERA and Economists Incorporated, respectively) that assert that the difference between rates in competitive and noncompetitive markets should have been evaluated separately for large and small systems. However, those studies do not explain why system size is a relevant factor, why it is the only additional factor that the FCC needs to consider,[13] or how it determined that 5,000 or 10,000 subscribers should be the cut-off point between large and small systems. Viacom submitted a study by the Rand Corporation which bases one of its primary conclusions on an analysis that it admits (at page 14) does not yield statistically significant results.

Second, the studies, even at their best, are equivocal. The NERA and Economists Incorporated studies, for example conclude that there is a high degree of error in the FCC's calculations and that benchmarks "could be as much as 25 percent wrong in either direction." NERA study at 3-4. That conclusion hardly justifies altering the benchmarks to favor operators. Third, the studies ignore the fact that there was a significant body of evidence before the Commission that rates should be reduced dramatically across the board, evidence that in fact shows that

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[13]Other industry studies assert that other factors are critical in evaluating the rate differential between competitive and non-competitive systems. See e.g., discussion of the RAND study submitted by Viacom, infra. It is also noteworthy that while some industry comments suggest that the FCC relied too heavily on rates for "small" systems (See e.g., NERA study at 2), others criticize the FCC for relying too heavily on rate data from "large" systems. See e.g., CATA petition at 16.

the benchmarks are too generous. Sideways attacks on the FCC's regressions simply do not overcome the weight of that evidence. For example, NCTA concludes that there is no "statistical evidence" that reducing rates for larger systems would result in compensatory rates. Economists Incorporated study at 8. But it has not rebutted the evidence that rates charged in communities facing competition have rates 30 to 40 percent lower than rates for non-competitive systems, (Report and Order at ¶ 561, RAND study at 9-10), or other evidence suggesting monopoly rents of 30 to 40 percent.

[illegible]

results of competition, the fact remains that the effects they describe are what one would expect in a competitive market.[14]

The finding that competitive systems offer better service at lower rates is not surprising. It is consistent with the conclusion that consumers are being forced to accept cable service they would never tolerate if they were not at the mercy of a monopoly operator. Likewise, it is unsurprising that in such as basic and expanded basic tier programming. That cannot be done by changing the benchmarks to allow operators to charge higher rates.[16]

2. The Operators Are Not Harmed By Inaccuracies in the Benchmark

Even assuming that the benchmark rates set by the FCC might be too low, there is no reason to reduce them because operators are not required to charge those rates; they are merely the "benchmark" against which operators compare their own, self-imposed rates. Under the FCC's system, operators will either charge the rates they are currently, voluntarily charging at the onset of regulation, or rates that reflect rates they voluntarily charged as of September 30, 1992, with up to, but no more than, a 10 percent reduction, augmented by inflationary adjustments. If the operator does not believe that the rates derived by the benchmark are adequate, it may institute a cost-of-service proceeding. Thus, operators are fully protected from any inaccuracies in the benchmark system.

The industry claims that the cost of service option does not provide adequate protection from allegedly non-compensatory national cost of service standards at all, but rather to let the methodology be determined by agreement between the operator and the franchising authority. See NCTA Comments at 41. There is no requirement that national cost of service standards be established, and nothing unfair about the fact that they have not been. The telephone industry has long been regulated under a variety of cost-of-service schemes. Nor is there any reason for the operators to presume that cost of service proceedings will not adequately protect operators' rights; under the FCC's rules, both FCC and court review will be available to the operator that feels it has not been treated properly. Some of the operators complain that cost of service proceedings may be too lengthy or burdensome. Corning petition at 12. As Coalition members have pointed out, there is no inherent reason why this must be so and in fact, the FCC rules ensure that cost-of-service proceedings will not result in unusual delays.

In their initial comments, the cable industry generally urged the FCC that cost of service regulation was a necessary safeguard to ensure that benchmark rates were not confiscatory. The industry won that battle. It can now hardly argue for a more generous rate allowance on the ground that a cost of service option unfairly harms operators.

### B. The Industry Has Not Shown Why Particular Systems Should Have Been Omitted From the FCC's Benchmark Calculations

Several industry petitions for reconsideration assert that, in assessing the rate differential between competitive and noncompetitive systems, the FCC included systems it should not have in its calculations. In particular, some of the petitions claim that municipally-owned systems (or systems in competition with municipal systems) should not have been considered. See e.g., NCTA petition, CATA petition, Harron petition. Also, some industry representatives assert that certain overbuild systems should not have been used as the basis for the FCC's benchmark calculations. See Harron petition. These assertions are without merit.

1. Municipal System Rates Were Properly Included

Some industry groups claim that looking at rates charged by municipal systems is inappropriate for purposes of determining what competitive rates would be. Municipal systems, the industry claims, are subsidized by other municipal funds. CATA petition at 17; NCTA petition 12. Moreover, they claim, municipal systems have cost advantages not available to private operators. Harron petition, Shew study at 11-12. Even if this were true,[17] the argument ignores significant cost advantages available to private operators but not to municipalities. The City of Manitowoc, Wisconsin is considering establishing a municipal system. Jones Intercable submitted "The Case Against Municipal Ownership," arguing, inter alia, that it enjoyed "economies of scale," "more discounts on programming" and the ability to "negotiate funds

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[17] [illegible]

from program suppliers" for marketing, all of which would permit it to out-compete a City-owned system.[18] While the industry makes bald contentions, it has presented no evidence that municipally-owned systems are able to, and do, provide service at lower costs than private operators could.

The industry has presented no support for its claim that municipalities subsidize their cable systems, or do not price cable rates at a level that will be profitable in the long run. In fact, there is strong evidence that the contrary is true. <u>See</u> Michigan Communities Opposition to Petitions for Reconsideration. In fact, municipal cable operations may subsidize general city funds. <u>Id.</u> (attached letter from Larry Hobart to John Pestle). Nevertheless, a study by William Shew found that municipal systems charged rates nearly 15 percent below rates charged by competing private systems.[19] Harron petition, Shew study at 12.

### 2. The Industry Has Not Shown Why Particular <u>Overbuild Systems Should Have Been Excluded</u>

The industry petitions also claim that some overbuild rates should not have been considered. In some cases, the industry claims, overbuilders are underpricing to force out the competition. NCTA claims generally that at least some overbuild

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[18]In addition, private operators enjoy tax write-offs and benefits not available to municipalities, including tax write-offs based upon depreciation. Note that the Malarkey-Taylor study submitted by NCTA included depreciation in its determination that

systems price so low that they cannot recover a reasonable profit. NCTA petition at 12. In support, it submitted a study in which the private operator in competition with a municipal system claimed it was losing money. See NCTA petition, Malarkey-Taylor study. But that assessment was based on a one-page conclusory statement by the private operator, asserting that it controlled the market. The RAND Corporation study, for example, recognizes that overbuild systems have fewer subscribers -- meaning more costs must be borne by each subscriber. Unless one assumes that the competitive systems are pricing at a level at which they could never earn a profit (a showing not made) there is no reason to assume that even such losses as may occur are not merely attributable to normal start-up expenses, plus that lower subscriber share. Neither factor justifies ignoring prices charged in systems where there is active competition in determining appropriate rates for other, non-competitive systems.[21]

The industry's petitions do not support their claims that municipal systems or certain overbuild systems should not have been included in the FCC's benchmark determinations. None of the evidence presented by the industry shows that the rates charged by the municipal or overbuild systems are non-compensatory.[22] None of the evidence shows that municipal systems face financial advantages that are not offset by advantages available only to

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[21]Indeed, it is far more questionable to blithely rely on rates allegedly charged where overbuilders have lasted for a lengthy period. Because of the industry's natural monopoly characteristics, such systems are far more likely to reflect structures where (a) each operator has a defined operating area and head-to-head competition occurs only in very limited area; or (b) duopoly pricing is occurring. Similarly, there is no reasons for the FCC to attempt to set prices based on a price that is sustainable, as the industry appears to suggest. Given the industry's characteristics, such a price is likely to be too high.

[22]See Michigan Communities opposition to petitions for reconsideration, refuting NCTA's erroneous allegations that the municipal system in Paragould, Arkansas is financially non-sustainable over the life of the cable system.